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State of New Jersey

DIVISION OF THE RATEPAYER ADVOCATE
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June 30, 2003

SEEMA M. SINGH, ESQ.
Acting Ratepayer Advocate
and Director

JAMES E. MCGREEVEY
Secretary

Marlene H. Dortch
Secretary
Federal Communications Commission
445 12th Street, SW, Room TWB-204
Washington, DC 20554

**Re: Notice of Proposed Rulemaking In the Matter of Section 272(f)(1) Sunset of
the BOC Separate Affiliate and Related Requirements
WC Docket No. 02-112**

**2000 Biennial Regulatory Review Separate Affiliate Requirements of Section
64.1903 of the Commission's Rules
CC Docket No. 00-175**

Dear Secretary Dortch:

Enclosed, please find an original and four copies of Comments being filed on behalf of the New Jersey Division of the Ratepayer Advocate in response to the above-captioned Federal Communications Commission's Further Notice of Proposed Rulemaking. We attempted to file these comments via the FCC's ECFS system but were not able to receive confirmation due to a technical difficulty with the FCC's website as confirmed by Bill Klein, supervisor of ECFS. Therefore, we would request your indulgence in considering these comments as timely filed. Thank you for your consideration. Please stamp the extra copy as filed and return it in the enclosed self-addressed stamped envelope.

Very truly yours,

SEEMA M. SINGH, ESQ.
RATEPAYER ADVOCATE

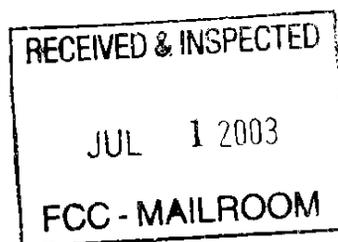
By:

Ava-Marie Madeam, Esq.
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JAMES E. MCGREEVEY
Governor

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*Acting Ratepayer Advocate
and Director*

June 30, 2003

Via the Electronic Comments Filing System

Marlene H. Dortch
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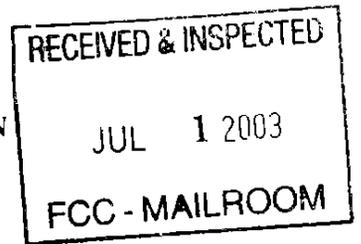
Very truly yours,

SEEMA M. SINGH, ESQ.
RATEPAYER ADVOCATE

By: /s/ Ava-Marie Madeam
Ava-Marie Madeam, Esq.
Assistant Deputy Ratepayer Advocate

cc: Janice M. Myles (via electronic mail)
Qualex International (via electronic mail)

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554



In the Matter of)
)
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Separate Affiliate Requirements of Section)
64.1903 of the Commission's Rules)

COMMENTS OF THE NEW JERSEY DIVISION OF THE RATEPAYER ADVOCATE

The New Jersey Division of the Ratepayer Advocate ("Ratepayer Advocate") submits these comments in response to the *Further Notice of Proposed Rulemaking* ("FNPRM") issued by the Federal Communication Commission ("FCC") on May 19, 2003 in the above-captioned proceeding. The *FNPRM* seeks comment on the appropriate regulatory classification of Bell Operating Companies ("BOCs") and independent local exchange carriers ("LECs"), if and when these carriers provide in-region, interstate and international, interexchange services outside of a separate affiliate.¹ The FCC poses three main questions in its *FNPRM*: (1) whether there is a continued need for dominant carrier regulation of BOCs' in-region, interstate and international interexchange telecommunications services after sunset of the Section 272 structural and related requirements in a state, (2) whether to classify independent LECs as non-dominant or dominant in their provision of in-region, interstate and international interexchange telecommunications services if the Commission eliminates or modifies the separate affiliate requirements currently

¹ *I/M/O Section 272(f)(1) Sunset of the BOC Separate Affiliate and Related Requirements, 2000 Biennial Regulatory Review Separate Affiliate Requirement of Section 64.1903 of the Commission's Rules*, WC Docket No. 02-112, CC Docket No. 00-175, FCC 03-111, Further Notice of Proposed Rulemaking (2003). ("FNPRM").

imposed on independent LECs, and (3) whether there are alternative regulatory approaches in lieu of dominant carrier regulation to address any potential anticompetitive behavior.²

As accurately stated by the FCC in the instant *FNPRM*, in order to evaluate the appropriate regulatory requirements for BOCs and independent LECs who provide in-region, interstate and international interexchange telecommunications services, it is paramount to perform a market power analysis identifying the market power these carriers possess in the markets they provide services.³ This market power analysis was central to the framework outlined in the FCC's *LEC Classification Order*⁴ which determined whether a carrier was dominant by: 1) delineating the relevant product and geographic markets for examination of market power, 2) identifying firms that are current or potential suppliers in that market, and 3) determining whether the carrier under evaluation possesses individual market power in that market.⁵

In the *LEC Classification Order*, the FCC articulated that dominant carrier regulation should be imposed on a carrier only if it could unilaterally raise and sustain prices above competitive levels and thereby exercise market power by restricting its output or by its control of an essential input, such as access to bottleneck facilities.⁶ Dominant carriers, unlike non-dominant carriers, are subject to price-cap regulation, must file tariffs on 14, 45, or 120 days' notice, with supporting cost data for above-cap and out-of-band tariff filings, and must submit

² *FNPRM* at ¶¶ 2-3.

³ *Id.* at ¶ 8.

⁴ See *Regulatory Treatment of LEC Provision of Interexchange Services Originating in the LEC's Local Exchange Area*, CC Docket No. 96-149, Second Report and Order in CC Docket No. 96-149 and Third Report and Order in CC Docket No. 96-611, 12 FCC Rcd 15756, 15775, 15776, 15782 (1997) (*LEC Classification Order*).

⁵ *Id.*

⁶ *Id.* at 15802-15803, para. 83.

additional information for new service offerings.⁷ In the *LEC Classification Order*, the FCC was cognizant of the fact that BOCs and independent LECS had monopoly power in the local exchange and access markets and that additional safeguards were necessary to ensure that such market power was not utilized to the detriment of ratepayers.⁸ Armed with this knowledge, the FCC concluded that Section 272(b) coupled with the requirements of 272(e)(1)⁹ and 272(e)(3)¹⁰ would provide adequate assurances that a BOCs' abuses of market power could be identified and remedied, and in turn classified the BOC interLATA affiliates as non-dominant in their provision of in-region long distance services.¹¹ For independent LECs, the FCC concluded that the separate affiliate requirements established in the *Competitive Carrier Fifth Report and Order*¹² along with other safeguards would provide adequate assurances that abuses of market power could be identified and remedied.¹³ The *Competitive Carrier Fifth Report and Order* required that interexchange carriers affiliated with independent LECs would be regulated as non-dominant provided that the affiliate providing interstate interexchange services: (1) maintains separate books of account, (2) does not jointly own transmission or switching facilities with its

⁷ *Id.* at 15766, para. 12.

⁸ *Id.* at 15823, 15825, paras. 116, 119.

⁹ Section 272(e)(1) provides that BOCs and their incumbent LEC affiliates "shall fulfill any requests from an unaffiliated entity for telephone exchange service and exchange access within a period no longer than the period in which it provides such telephone exchange service to itself or to its affiliates."

¹⁰ Section 272(e)(3) requires that BOCs and their LEC affiliates charge their interLATA affiliates, or impute to themselves an amount for access to telephone exchange service and exchange access "that is no less than the amount charged to any unaffiliated interexchange carrier for such service."

¹¹ *Id.* at 15762-15763, para. 6.

¹² See *Policy and Rules Concerning rates for Competitive Carrier Services and Facilities Authorizations Therefor: Fifth Report and Order*, CC Docket No. 79-252, 98 FCC2d 1191, (1984) ("*Competitive Carrier Fifth Report and Order*").

¹³ *LEC Classification Order* at 15763, para. 7.

affiliated exchange telephone company; and (3) acquires any services from its affiliated exchange telephone company at tariffed rates, terms, and conditions.¹⁴

In the case of BOCs, the fundamental purpose of Section 272 was to provide safeguards against anti-competitive conduct. The enactment of this provision necessarily recognized that the BOCs could otherwise persist in the exercise of their market power absent certain constraining forces. As prescribed by the Telecommunications Act of 1996, these Section 272 separate affiliate requirements expire three years after the BOC gains long distance authority in a particular state, unless extended by the FCC. So far, the Section 272 requirements have sunset for Verizon in New York in December 2002 and will soon sunset for SBC Communications in Texas in June 2003.

As noted above, the FCC chose to impose separate affiliate rules on independent LECs as a condition of avoiding dominant carrier status. Absent these safeguards, the FCC found that independent LECs have monopoly control over bottleneck exchange facilities. As a result, such LECs unquestionably have both the incentive and ability to favor their long distance operations anticompetitively through cost misallocation, discriminatory interconnection, and price squeezes.¹⁵

The Ratepayer Advocate submits that independent LECs should continue to be subject to the requirements of the *Competitive Carrier Fifth Report and Order*, and these requirements should also be imposed on BOCs once sunset of the Section 272 requirements occurs in order to provide disincentives to engage in discriminatory behavior. Very little has changed since the FCC found it crucial in the *Non-Accounting Safeguards Order*, to implement safeguards, because

¹⁴ See *Competitive Carrier Fifth Report and Order*, 98 FCC2d at 1198, para. 9.

¹⁵ *LEC Classification Order* at paras. 158-59.

their findings revealed that BOCs and independent LECs have market power in the provision of local exchange and exchange access services in their respective service areas.¹⁶ Market power enables a BOC or independent LEC to overprice services where little competition is present or to compensate for areas in which a company is facing competition. Clearly, the BOCs and independent LECs still have market power and therefore the ability to discriminate against competitors. The incentive to discriminate is also present, since BOCs that have received Section 271 approval are eager to increase their long distance market shares. SBC, for example has placed a “strong emphasis on bundling long distance with local calling services and features.”¹⁷ As a result, SBC’s winback rate in the five SBC Southwestern Bell states – where the company offers bundled local and long distance service – is 50%, approximately double SBC’s winback rate in its other regions.¹⁸

If Section 272 requirements sunset and elimination of the separate affiliate requirements for independent LECs occurs, then no prophylactic constraints on the BOCs’ and independent LECs’ behavior will remain. The lack of regulatory constraints will not only greatly increase the risk of harm to competition, it will also fatally undermine the FCC’s ability to detect violations and to enforce its rules prohibiting such practices. It is therefore imperative that once the Section 272 rules sunset for BOCs, these requirements be replaced by the separate affiliate requirements currently in place for independent LECs in order to prevent noncompetitive behavior from developing.

¹⁶ *Implementation of the Non-Accounting Safeguards of Section 271 and Section 272 of the Communications Act of 1934, as amended*, CC Docket NO. 96-149, First Report and Order and Further Notice of Proposed Rulemaking, 11 FCC Rcd 21905, 21911-12, para. 10 (1996) (“*Non-Accounting Safeguards Order*”).

¹⁷ See SBC First Quarter 2002 Investor Briefing (April 18, 2002) at 7.

¹⁸ See SBC Second Quarter 2002 Investor Briefing (July 23, 2002) at 6-7.

It has been demonstrated that retaining the separate affiliate requirements of the *Competitive Carrier Fifth Report and Order* with respect to independent LECs and the application of these requirements to BOCs would not impede either the BOCs' or the independent LECs' ability to compete. The BOCs who have gained Section 271 in-region interLATA approval have had little difficulty competing even with the separate affiliate requirements of Section 272. Verizon is now the nation's third largest long distance carrier with more than ten million customers in 47 states.¹⁹ More than 50% of Verizon's long distance customers are in states in the former Bell Atlantic territory.²⁰ The company has 2.7 million customers in New York and Connecticut, 1 million customers in both Massachusetts and Pennsylvania, and nearly 500,000 customers in New Jersey.²¹ Similarly, SBC has been able to capture a significant share of the long distance market in the six states in which it is authorized to provide interLATA service.²² SBC added 1.5 million long distance lines in the first quarter of 2003 to reach 7.6 million long distance customers, an increase of 20% from three months earlier.²³ In California, one of SBC's strongest markets, SBC has achieved long distance line penetration levels of 13% in the consumer segment and 10% overall in that state.²⁴

The BOCs' and the independent LECs' gains in market share in the long-distance sector have already impacted the business of AT&T, the nation's largest long distance carrier. In a recent article, AT&T attributes its recent stock downgrade to "tougher competition from rivals

¹⁹ See Verizon Investor Quarterly, Fourth Quarter 2002 (January 13, 2003) at 16.

²⁰ *Id.* at 5.

²¹ *Id.*

²² The six states include Texas, Missouri, Oklahoma, Kansas, Arkansas, and Connecticut.

²³ See SBC First Quarter 2003 Investor Briefing (April 24, 2003) at 7.

²⁴ *Id.*

like Verizon Communications and SBC Communications, which are offering cheap bundles of local, long-distance, wireless and Internet service."²⁵ The ability of BOCs and independent LECs to bundle telecommunications services provides them with the perfect opportunity to ultimately gain monopoly control of the long distance market. Therefore, the FCC should maintain the requirements of the *Competitive Carrier Fifth Report* for independent LECs, and also make such requirements applicable to BOCs, or risk a demise of competition in the long distance market.

The Ratepayer Advocate submits that the FCC's prior concerns about the proclivity for BOCs and independent LECs to engage in discriminatory behavior in the absence of separate affiliate requirements is correct. The current economic climate in the telecommunications industry, including the exit of several competitors from the marketplace, reinforces these concerns. One possible alternative to dominant carrier regulation that the FCC might consider is the implementation of effective non-structural safeguards to preclude future abuses of market power by BOCs and independent LECs alike.

The FCC could, at the very least, adopt reporting requirements, metrics, standards, and penalties to ensure that BOCs and independent LECs provide nondiscriminatory access to their facilities. The Ratepayer Advocate submits that BOCs and independent LECs could be required to file quarterly performance reports to the FCC. Most importantly, the FCC could establish benchmark performance standards for each service category, and require the BOCs and independent LECs' performance to meet the benchmark standard in order to prove that they are

²⁵ Tom Johnson, *AT&T Stock Slides After Latest Analyst Downgrade*, THE STAR LEDGER, June 18, 2003, at 43.

providing nondiscriminatory service to non-affiliates.²⁶ These reporting requirements, accompanied by self-executing remedies, would equip the FCC with the necessary tools to detect instances of discrimination and cost allocation by BOCs and independent LECs and to address misbehavior by these carriers. Moreover, in order to prevent the performance reporting regime from being undermined, the Ratepayer Advocate recommends that the FCC consider conducting a comprehensive annual audit of the quarterly reporting requirements. The audit would include a detailed review of the BOCs' and independent LECs' procedures for complying with the reporting guidelines, in addition to reviewing the data reported for accuracy.

CONCLUSION

The Ratepayer Advocate strongly urges the FCC to consider the effect on competition if the BOCs and independent LECs are allowed to provide in-region, interstate and international interexchange services outside of a separate affiliate, and liberated of the structural safeguards already in place. The Ratepayer Advocate submits that both BOCs and independent LECs must be subject to the aforementioned structural safeguards outlined in the *Competitive Carrier Fifth Report and Order*, as necessary tools to accomplish the goals and objectives of the Act, especially in an ever-shrinking telecommunications market. While the 1996 Act has fostered more competition, and in turn the prospects of competition has fueled economic growth, investment and development, the overt market power of these carriers can potentially overpower

²⁶ *Performance Measurements and Standards for Unbundling Network Elements and Interconnection*, CC docket 01-318. Notice of Proposed Rulemaking at ¶ 32, FCC 01-331, (rel. Nov. 19, 2001) (recognizing that proper benchmark standards for each measurement are important to any performance plan).

nascent competition and frustrate economic investment, development, and enthusiasm, an outcome the FCC must take definitive steps to avoid.

Respectfully submitted,

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Dated: June 30, 2003